

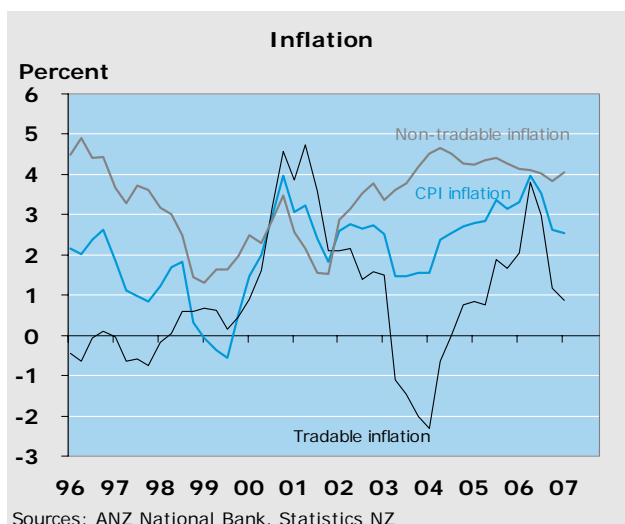
## CONSUMERS PRICE INDEX – MARCH QUARTER 2007

### Key points

- **Headline inflation came in slightly below expectations at 0.5 percent for the quarter, taking the annual headline inflation rate to 2.5 percent.**
- **However, non-tradable CPI accelerated to 1.2 percent, taking annual non-tradable inflation to 4.1 percent.**
- **Other core measures of inflation deteriorated, with the trimmed mean up 0.6 percent and the weighted median up 0.7 percent. We suspect that the RBNZ's other calculated measures of core inflation (exponential smoothing, factor model) will also similarly show a pick-up.**
- **Housing and services components continue to show strong inflationary pressure, with further cost-push pressure to come.**
- **With the REINZ data due tomorrow likely to show another strong print, we believe the run of data is simply becoming painful.**
- **We are now officially calling a 25 basis point increase in the OCR to 7.75 percent next week.**

### The headlines

	Actual	ANZ National	RBNZ	Market
Headline CPI	<b>0.5% qoq</b> <b>2.5% yoy</b>	0.4% qoq 2.4% yoy	0.3% qoq 2.3% yoy	0.6% qoq 2.6% yoy



CPI Components	Quarterly % change	%-point contrib.	Annual % change
Food	1.1	0.2	3.9
Alcohol and Tobacco	1.0	0.1	3.6
Clothing and Footwear	-0.5	0.0	-0.5
Housing and Household Utilities	1.1	0.2	5.3
Household Contents and Service	-1.0	-0.1	0.2
Health	1.1	0.1	1.5
Transport	-0.2	0.0	0.4
Communication	0.1	0.0	1.5
Recreation and Culture	-0.7	-0.1	0.8
Education	3.4	0.1	4.2
Miscellaneous Goods and Service	1.2	0.1	3.3
<b>All Groups</b>	<b>0.5</b>	<b>0.5</b>	<b>2.5</b>
<b>Tradables</b>	<b>-0.4</b>	<b>-0.2</b>	<b>0.9</b>
<b>Non-tradables</b>	<b>1.2</b>	<b>0.6</b>	<b>4.1</b>
<b>Trimmed Mean</b>	<b>0.6</b>		<b>3.0</b>
<b>Weighted Median</b>	<b>0.7</b>		<b>3.7</b>

- **The March quarter CPI rose by 0.5 percent, taking annual inflation to 2.5 percent.** The housing and household utilities group again made the largest contribution to the quarterly change in the CPI, up 1.1 percent in the quarter (a 0.2 percentage point contribution). This was driven by a 1.0 percent increase in actual rentals for housing, home ownership prices (1.3 percent), energy prices (1.3 percent) and property maintenance prices (up 1.5 percent). Of respondents reporting increases in the March 2007 quarter for home ownership costs, 93.0 percent cited higher prices for construction components and 75.0 percent cited increased subcontractors' charges, clearly a consequence of the still robust housing market and significant capacity constraints evident in the construction sector. Food prices also made a large contribution to the quarterly rise in the CPI. Poultry prices in particular, rose strongly increasing by 15.2 percent in the quarter, with increases in world grain prices the likely cause of this increase. Other groups to record price increases in the quarter were alcoholic beverages and tobacco (1.0 percent), health (1.1 percent), communication (0.1 percent), education (3.4 percent), and the miscellaneous goods and services group (1.2 percent). The clothing and footwear group (-0.5 percent), the transport group (-0.2 percent), the recreation and cultural

group (-0.7 percent) and the household contents and services group (-1.0 percent) were the groups to record declines in the March quarter.

- **Annual non-tradables inflation accelerated to 4.1 percent from 3.8 percent.** Non-tradables inflation rose by 1.2 percent in the quarter, the largest increase since December 2003, after increases of 0.8 percent and 1.0 percent in the December and September 2006 quarters respectively. After falling below 4.0 for the first time since September 2003 in the December 2006 quarter, non-tradable inflation has once again picked up. From a pure presentation perspective, annual non-tradable inflation is now rising as opposed to easing. Tradables inflation fell by 0.4 percent in the March quarter, taking annual inflation to 0.9 percent with the high currency clearly having an impact.
- **Core measures of inflation picked up in March.** The 10 percent trimmed mean remained unchanged at 3.0 percent on an annual basis, while the annual increase in the weighted median measure rose to 3.7 percent, from 3.3 percent in the December quarter. On a quarterly basis, both the trimmed mean and weighted median rose to 0.6 and 0.7 percent respectively. The percentage of items recording an increase in price in March was 50.7 percent, slightly below the 55.2 percent recorded in December. However, when expressed as a percentage of expenditure weights 66.8 percent recorded an increase in price, up from 64.3 percent in the December quarter.

### [Assessment and implications](#)

**The run of data continues to disappoint the RBNZ.** Today's data continues a string of data that has mostly surprised on the upside. Even adjusting for higher petrol prices since the March *MPS*, the RBNZ would have been expecting headline CPI to print at 0.4 percent (from 0.3 percent). The 1.2 percent print in non-tradable CPI compared to the RBNZ's 0.9 percent forecast and rising annual rate is a clear indication that strong domestic demand is now feeding into inflation pressure. Tomorrow's REINZ housing market report for March will only add to the RBNZ's frustration. To be fair, the March rate hike has yet to have much of an impact and the recent increases in fixed mortgage rates will only start to appear in the dataflow around mid-year. But the resilience of the activity indicators in the QSBO (which was taken after the March hike) and the spike up in non-tradable inflation will be testing the Reserve Bank's patience. The broad based nature of price increases also highlight a generalised under-current of inflation pressure seeping into consumer prices.

**The Reserve Bank has shown a tendency to look through near-term inflation outcomes with their focus (correctly) on medium-term trends.** Based on this we remain wary about putting excessive weight on the strong quarterly non-tradable result in itself (or even the slightly weaker than consensus headline outturn). The economy does look to be sitting on a dangerous precipice. The material tightening in financial conditions (via increases in wholesale and fixed lending rates and a NZD at post-float highs) are strong factors urging caution. We believe recent rises in fixed lending rates courtesy of the credit channel of monetary policy should be a material influence on their deliberations.

**Yet the balance of risks now looks skewed towards a further hike.** We expect the Reserve Bank to hike interest rates by 25 basis points next week, taking the OCR to 7.75 percent, and leave the door open to a further move. Following the March hike, we saw the threshold to a further follow up move as lower. Upside surprises in the data are now becoming painful and difficult to ignore despite there being little data to assess conditions post the March hike, including the impact of the rise in retail mortgages rates and strong currency. While there is a case for caution and potentially waiting until June to assess conditions, this will merely create unnecessary volatility - and goes against one of the legs of the Policy Targets Agreement.

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